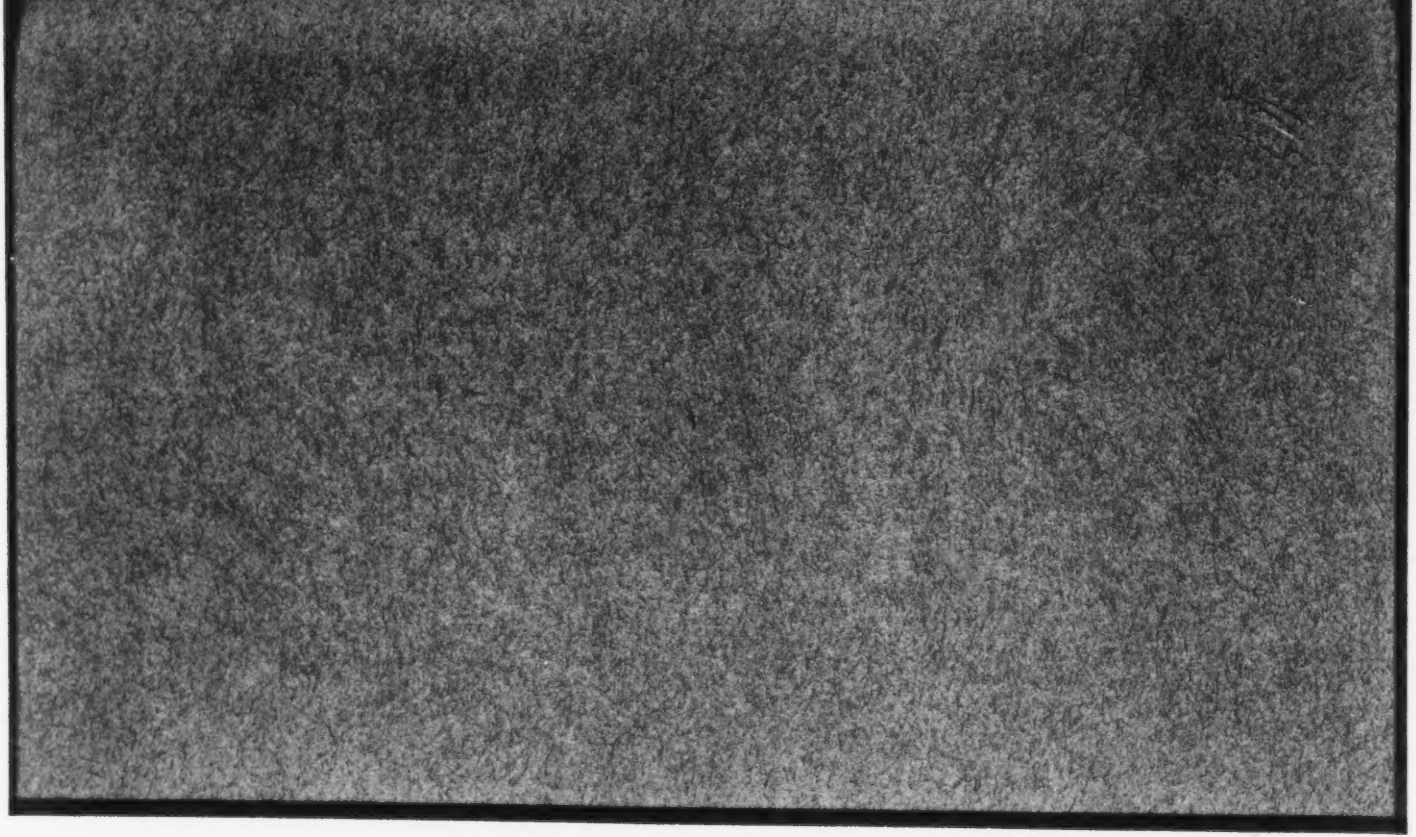

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414316—41

In the Supreme Court of the United States

OCTOBER TERM, 1941

No. 564

MASCOT STOVE COMPANY, PETITIONER

v.

GUY T. HELVERING, COMMISSIONER OF INTERNAL REVENUE

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE SIXTH CIRCUIT

BRIEF FOR THE RESPONDENT IN OPPOSITION

OPINIONS BELOW

The original opinion of the Board of Tax Appeals is an unreported memorandum opinion (R. 13–25),[1] which upon review by the whole Board was thereafter modified (R. 26–39), and reported in 40 B. T. A. 1057. The opinion of the Circuit Court of Appeals (R. 46–51) is reported in 120 F. (2d) 153.

[1] This is not properly a part of the record. Section 906 (b) of the Revenue Act of 1924, 43 Stat. 253, as amended by Section 601 of the Revenue Act of 1928, 45 Stat. 791 (U. S. C., Title 26, Sec. 618 (b)).

JURISDICTION

The judgment of the Circuit Court of Appeals was entered on June 3, 1941. (R. 45.) The petition for a writ of certiorari was filed August 29, 1941. The jurisdiction of this Court is invoked under Section 240 (a) of the Judicial Code, as amended by the Act of February 13, 1925.

QUESTION PRESENTED

After the adjudication in bankruptcy, certain stockholders of the bankrupt corporation purchased its assets from the trustee in bankruptcy, formed a new corporation and transferred the assets to the new corporation. Did the new corporation acquire those assets pursuant to a "reorganization" within the meaning of Section 112 (i) (1) of the Revenue Act of 1932, so that its basis for those assets was the same as the basis of the old corporation?

STATUTES INVOLVED

Revenue Act of 1932, 47 Stat. 169:

> SEC. 112. RECOGNITION OF GAIN OR LOSS.
>
> * * * * *
>
> (i) *Definition of Reorganization.*—As used in this section and sections 113 and 115—
>
> (1) The term "reorganization" means (A) a merger or consolidation (including the acquisition by one corporation of at least a majority of the voting stock and at least a majority of the total number of shares of all other classes of stock of an-

other corporation, or substantially all the properties of another corporation), or (B) a transfer by a corporation of all or a part of its assets to another corporation if immediately after the transfer the transferor or its stockholders or both are in control of the corporation to which the assets are transferred, or (C) a recapitalization, or (D) a mere change in identity, form, or place of organization, however effected.

(2) The term "a party to a reorganization" includes a corporation resulting from a reorganization and includes both corporations in the case of an acquisition by one corporation of at least a majority of the voting stock and at least a majority of the total number of shares of all other classes of stock of another corporation.

* * * * *

SEC. 113. ADJUSTED BASIS FOR DETERMINING GAIN OR LOSS.

(a) *Basis (Unadjusted) of Property.*— The basis of property shall be the cost of such property; except that—

* * * * *

(7) *Transfers to corporation where control of property remains in same persons.*— If the property was acquired after December 31, 1917, by a corporation in connection with a reorganization, and immediately after the transfer an interest or control in such property of 50 per centum or more remained in the same persons or any of them, then the basis shall be the same as it would be in the hands of the transferor, increased

in the amount of gain or decreased in the amount of loss recognized to the transferor upon such transfer under the law applicable to the year in which the transfer was made. This paragraph shall not apply if the property acquired consists of stock or securities in a corporation a party to the reorganization, unless acquired by the issuance of stock or securities of the transferee as the consideration in whole or in part for the transfer.

* * * * *

STATEMENT

On June 20, 1933, the Mascot Stove Manufacturing Company, hereinafter called the old company, was adjudicated an involuntary bankrupt (R. 3, 27). Its real estate and machinery, tools, and other equipment were encumbered by a mortgage which together with interest and taxes exceeded $30,000. The property covered by the mortgage was appraised in the bankruptcy proceedings for less than the amount of the mortgage (R. 27).

On July 7, 1933, Alvin Ziegler, acting as trustee for a group of stockholders of the old company (R. 27–28), made an offer to pay $7,500 for those assets of the old company which were not covered by the mortgage. These assets, which had been appraised at $9,280.50, consisted mainly of an inventory of materials and an equity in accounts receivable. The accounts receivable were subject

to a lien in favor of a finance company and the old company's equity in these accounts was appraised at $2,351.75 (R. 27). Ziegler's offer was accepted. The terms of the sale required the payment of $2,500 in cash and the delivery of four notes payable in 30, 60, 90, and 120 days. In this transaction Ziegler represented persons who held a total of 3,076 shares out of approximately 3,800 outstanding shares of the old company (R. 27–28).[2]

On July 3, 1933, one Luke O. Morin, an associate of Ziegler, acting as trustee for himself and a corporation to be organized, had made an offer to the trustee in bankruptcy to pay $50 for the mortgaged property, the conveyance to be made subject to the mortgage and existing liens. This offer was accepted by the trustee in bankruptcy (R. 27).

On July 7, 1933, application for the incorporation of the petitioner herein, the Mascot Stove Company, hereinafter called the new company, was made in Tennessee. The charter was issued on July 8, 1933 (R. 28). The new company was authorized to issue 500 shares of preferred stock having a par value of $100 per share and 5,000

[2] Whether Ziegler also represented the petitioner was the subject of a lively controversy in the Board of Tax Appeals (R. 33). The Board held that he did (R. 35), but that the same result would be reached in any event (R. 36). Petitioner apparently agrees it is a matter of indifference whether petitioner acquired the assets directly from the trustee in bankruptcy or indirectly through Ziegler (Pet. 6–7).

shares of no par common stock. Alvin Ziegler subscribed for 10 shares of the preferred stock for himself and 50 shares for two other persons who were stockholders in the old company (R. 29–30). The preferred stock was paid for in cash, $6,000 (R. 30). Ziegler transferred to the new company the inventory assets and accounts receivable of the old company; the assets of the old company which had been subject to the mortgage were deeded to the new company by the mortgagee (the mortgagee had foreclosed on the mortgage (R. 29)), and the new company executed a new mortgage to the mortgagee. The new company paid Ziegler $2,500 in cash for the assets which he had transferred to it and executed to him four notes corresponding to the notes which Ziegler had executed to the trustee in bankruptcy for those assets (R. 31). These four notes were paid by the new company (R. 31). The new company also issued to Ziegler and the stockholders whom he represented 5,000 shares of no par common stock. The interest of each person in the property acquired by Ziegler at the bankruptcy sale was in the ratio that the number of shares held by him in the old company bore to the total number of shares in the old company represented by the group of stockholders for whom Ziegler was the trustee (R. 31). The amount of stock in the new corporation which each was entitled to receive and did receive was in substan-

tially the same proportion as his ownership of the assets exchanged for stock, although the stock certificates issued at a later date were not in the same proportion (R. 31).

The new company realized a profit in the fiscal year ending June 30, 1934, on certain assets which it had acquired in the above-described transactions. The issue between the Government and the taxpayer is as to the proper basis for the determination of the gain. The Commissioner determined that the basis was the price paid for the assets by the taxpayer and his determination was sustained by the Board of Tax Appeals and by the court below. The taxpayer maintains that its basis is the same as the basis of the assets in the hands of the old company, upon the theory that they were acquired pursuant to a "reorganization" within the meaning of Sections 112 (i) and 113 (a) (7) of the Revenue Act of 1932.

ARGUMENT

1. The court below correctly held that the purchase of assets at the bankruptcy sale either directly by petitioner or indirectly through certain individuals, did not constitute a reorganization.

The old company was insolvent and the old stockholders' equity had been wiped out. To the extent that any of the old stockholders acquired an interest in the new company, they acquired it by purchase for cash at the bankruptcy sale.

Their interest in the new company did not stem from their ownership of stock in the old company, and the situation is no different from what would be the case if total strangers had made the purchase at the sale. There was absent the necessary continuity of a proprietary interest between the old and new companies (cf. *Le Tulle* v. *Scofield,* 308 U. S. 415, 420), since no interest in the new enterprise was attributable to the stockholders' former position in the old company. Thus the clean break between the two companies does not justify the new company in using the high basis for its assets which they had in the hands of the old company.

The decision herein is not in conflict with *Rex Mfg. Co.* v. *Commissioner,* 102 F. (2d) 325 (C. C. A. 7th), which the court below fully distinguished when it noted (R. 50) that there was actually an equity in the old enterprise in that case which was transferred to the new company. The question in the instant case is now being presented to the Circuit Court of Appeals for the Seventh Circuit in *D. W. Klein Co.* v. *Commissioner* (decided by the Board of Tax Appeals in an unreported opinion September 19, 1940), and until that court undertakes to extend its decision in the *Rex* case to this situation, it cannot be said that a conflict exists between the two circuits.

2. Petitioner alleges conflict (Pet. 8) with *Commissioner* v. *Kitselman,* 89 F. (2d) 458 (C. C. A.

7th) and *Commissioner* v. *Newberry L. & C. Co.*, 94 F. (2d) 447 (C. C. A. 6th) in that it was held in each of those cases that a reorganization within the meaning of the revenue acts could be effected through the medium of bankruptcy or equity insolvency proceedings. But, as carefully pointed out in the opinion below (R. 50), the court did not hold that a reorganization could not be effected by employing the mechanics of bankruptcy. Indeed, the *Newberry* case was decided by the same circuit court of appeals that decided the instant case, and there isn't the slightest suggestion it has overruled itself here.

The question presented in those cases, namely whether there is a sufficient continuity of interest to effect a reorganization where the creditors of the old company become the stockholders of the new company, is now pending before this Court in a group of cases on petitions for certiorari filed both by the Government and by taxpayers. *Helvering* v. *Southwest Consol. Corp.*, No. 286; *Helvering* v. *Alabama Asphaltic Limestone Co.*, No. 328; *Bondholders Committee, Marlborough Investment Co.* v. *Helvering*, Nos. 128, 129; *Palm Springs Holding Corp.* v. *Helvering*, No. 503. Although the issue there involved turns upon the interpretation of the statutory definition of reorganization, as does the instant case, the fact patterns are entirely dissimilar, and a holding with respect to the existence of a reorganization in

those cases should not have any controlling effect upon the present case. Accordingly, the pendency of those cases should not be a reason for granting the writ here.

CONCLUSION

The case was correctly decided by the court below. There is no conflict of decisions. The petition should not be granted.

Respectfully submitted.

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